Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)
	)
Exclusive Service Contracts for Provision of Video	) MB Docket No. 07-51
Services in Multiple Dwelling Units and	) FCC 07-32
Other Real Estate Developments	)

To: The Commission

COMMENTS OF THE INDEPENDENT MULTIFAMILY COMMUNICATIONS COUNCIL (IMCC)

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Dated: June 18, 2007

TABLE OF CONTENTS

I. Introduction

The Independent Multi-Family Communications Council ("IMCC") submits these Comments in response to the Notice of Proposed Rule Making, FCC 07-32. IMCC represents Private Cable Operators ("PCOs"), also referred to as satellite master antenna television providers, equipment manufacturers, program distributors and property ownership-management-development companies. PCOs employ a variety of telecommunications technologies, both wired and wireless, to offer analog and digital video, voice and data communications services, referred to as the triple play, primarily to the residential multiple dwelling unit ("MDU") market. With regard to video services, these operators primarily compete with franchised cable operators, the dominant player in the local multi-channel video programming distribution ("MVPD") market. The issues raised in this proceeding are of critical importance to IMCC members since the Commission's conclusions will, in large part, determine whether IMCC's operator members are able to build upon their current toehold in the market for distribution of the triple play and present more meaningful competition in the long term. Also, some competition exists with RBOCs/LECs and telcos. Although these competitors have only recently entered the MDU marketplace, they do provide service in limited regions of the country, although not in the entire footprints where they offer telephony service. Regardless, they are significant, or at least potentially so. It is assumed this explains why this Notice was issued. This is particularly interesting since the FCC spent 5 years studying virtually the same matters in 95-184. Thereafter, the FCC also studied many of the same issues in the Competitive Networks Matter. In this Proceeding, IMCC assumes that no advocate of eliminating exclusivity has entered into any such contracts.

II. Summary

In its comments in those proceedings, IMCC focused on the issues the Commission has again raised regarding potentially precluding or imposing limitations on the use of exclusive service/access contracts, other avenues the FCC could pursue to enhance video competition and numerous questions about how all these issues effect the end use consumer.

In this filing, IMCC urges the Commission not to preclude the use of exclusive service/access contracts. If that is to happen then let the market place make such a determination. Nor should the Commission impose any artificial and external limit on the duration of exclusive service contracts. Here again we urge the Commission to allow the involved parties to govern such contractual provisions so that MDU residents are benefited. IMCC does however believe a more purposeful activity of the Commission would be to focus on legal intrusions and forces diminishing competition such as perpetual contracts and mandatory access statutes, while improving the supposedly pro-competition but unfortunately inefficient tool known as the MDU Inside Wiring Rules.

In our view, the question of the continued current FCC position regarding exclusive service contracts is not, at its core, a matter of public policy requiring regulation. To the contrary. These contracts are a matter of and result of financial forces in the market place. These private contractual agreements are an outgrowth of the normal economic forces of capitalism. They are not similar to the intrusion of non-market forces such as certain regulations and statutes. But they are critical to the ability of PCOs to finance projects and provide alternatives to franchised cable companies and the new RBOC/telco entities in markets where property owners have historically enjoyed few options.

Bear in mind that MDU owners have as their primary objective to rent units. To do so residents must be pleased with all services provided in the community, including video and other communications services. Exclusive contracts provide a value to residents because through that contract there can be negotiation with any provider and residents receive better products and services. That is, on the residents' behalf, MDU owners have leverage with the providers. For instance, one thousand customers have more leverage than a customer in a single family home, that customer having no leverage. For this system to function there must be alternative providers, such as PCOs, to franchised companies or the RBOCs/telcos. If these alternative providers are not available in the market then that leverage is not present. Exclusive contracts allow PCOs to be present and provide that leverage. If such contracts are forbidden by the Commission this benefit to MDU residents will be lost.

Should the Commission ultimately decide to impose a cap on exclusive contracts, IMCC asks that the duration be at least as long as financial markets require in order for them to make expansion capital available, which is absolutely essential if PCOs are to offer enhanced competition. It is only over such a period that private operators can recoup costs, generate a return on investment and solidify their financial position to the extent required to withstand the highly financed competition from franchised operators, often times subsidized by its city or country-wide operations. Then PCOs can expand to additional MDU communities. A limited term duration, sufficient to meet the criteria above, is appropriate in most states if that period corresponds to the period of de facto exclusivity granted to most franchised operators or other entities enjoying the benefits of a franchise. Also, if experience indicates that this period is excessive, the Commission could simply revisit the issue with no harm to other entities developing in the interim. However, if the Commission imposes a cap of insufficient length, private operators may be forced out of the market before the Commission can take corrective action.

IMCC points out that states with mandatory access statutes almost always authorize franchised operators alone to force access and exclude private operators from their reach. Franchised operators can therefore preempt a private operator's exclusive contractual arrangement while its own such contracts remain shielded. In order to avoid this highly inequitable result, IMCC urges the Commission to prohibit franchised operators or RBOCs/telcos from obtaining exclusive contracts in states which have enacted mandatory access statutes.

Finally, our comments make clear that exclusive contracts are not needed to assist large operators. If a company has "market power" or "market dominance" and surpasses in size any definition of "small", each of which have been used by the

FCC in the past to achieve productive regulatory actions, that company should not be allowed to use such contracts because it is already extremely well financed and it does not need to have the benefits of such contracts.

III. Discussion

A. Exclusive Contracts Are A Pro-Competitive Tool

Exclusive contracts are a pro-competitive tool for entities without market dominance and that are small entities that enhance competition in the video market and other aspects of communications which comprise the triple-play. In this NPRM, the Commission seeks comment on whether it should preclude exclusive contract provisions or adopt a cap on the length of exclusive contracts entered into by MDU owners and service providers, limiting their enforceability to the time period necessary for a provider to recover the capital investments required to initiate service at the MDU and to allow a rate of return sufficient to support expansion to other MDU residents. The collective experience of IMCC's members indicates that exclusive contracting by PCOs is absolutely essential to their ability to compete with incumbent franchised operators and other very large and well-financed entities and that these contracts promote the best interests of MDU residents. If PCOs had the resources to spend twenty-five billion dollars on capital expenditures in just the past few years, as has Verizon, then such contracts would serve no positive purpose.

As IMCC has emphasized to the Commission in past proceedings, exclusive contracts do not inevitably inhibit competition. Some parties have limited their analysis of the competitive effect of exclusive contracts to the confines of a single MDU property and argue that these contracts simply result in the replacement of one monopolist with another. However, the relevant geographic market for the distribution of video programming and the triple play services is not the grounds of a single MDU. Rather, for the large providers with market power, it is coextensive with the franchise area which usually extends throughout the entire incorporated area of a city or county, or now, in some states, to that entire state. While exclusive contracts may prevent a provider from offering its services at a particular MDU, they do not prevent a provider from entering the geographic market as a whole and competing at the property line. The various providers vie to convince a property owner that they are best able to offer to that property's residents the mix of services desired by current and prospective residents and at the best price, rather than competing at each resident's door. Thus, several providers can operate in a given market, each with a handful of exclusive contracts at particular MDUs, and the market will still be competitive as a result of the vigorous competition that has taken place property-by-property. IMCC urges the Commission to look beyond the misplaced focus of some parties on the type of door-to-door competition that takes place in the single family home context and to recognize that competition plays out in a dramatically different manner in the MDU environment.

B. The Record Establishes That Exclusive Contracts Can Promote Competition

In previous Comments, IMCC extensively briefed why the ability of new entrants to execute exclusive service contracts does not diminish competition, but enhances it. More will be said about these matters latter in this submission. The addition of RBOCs and telcos to that market does not alter those views as they relate to PCOs serving residents in MDUs. Given the Commission's overriding objective to spark and extend competition in the provision of video services nationwide, it would appear that the MDU market is one market that should not be subjected to any further regulatory controls except where clear evidence exists of anticompetitive activity --such as in the case of contracting in perpetuity. This is particularly true in situations when the provider does not exert market power or dominance and is small by any definition. Exclusivity also provides new entrants with an opportunity to recoup costs and generate a sufficient rate of return to expand to other MDU communities. Without exclusivity, a new entrant could easily succumb to the overwhelming marketing powers and questionable tactics of the incumbent that has great financial resources and has already recouped their investment, both from that individual MDU community but also from a huge customer base, often nationwide in scope. The incumbent provider can therefore easily undersell its new competitor and lure away subscribers with special promotions. For example, a cable franchisee can subsidize head-to-head competition at a particular MDU with revenues obtained from its franchise-wide single-family subscriber base. Since the Commission has done away with meaningful uniform pricing regulations, and the remainder are diminished in effect by loopholes that allow much larger providers to continue such cross-subsidization and price undercutting, exclusive contracts are essential if PCOs are to remain viable.

A related fact is that franchised cable and the RBOCs/telcos are able to buy programming at rates far less than PCOs can acquire the same programming. This difference in costs is approximately 20% and programming is some 40% of all PCO costs. Thus, a reasonable period of exclusivity provides new entrants with an essential degree of protection while they recoup costs, stabilize financially and generate a return on investment.

Even assuming a PCO can utilize exclusive contracts, it takes approximately 7 years for that operator just to recoup the costs of installing its system, disregarding the time value of money, let alone attracting new capital so that PCOs are able to provide competitive services in additional MDU communities.

The need of PCOs for some reasonable period of exclusivity is no different than that experienced by franchised operators when they were starting operations thirty years ago or so. Then the Commission recognized the value to society of this technology and companies and took numerous steps to assure their success. Similar treatment for PCOs is warranted and it would be inequitable to deny PCOs the same protection. In a significant court case, a major franchised operator candidly stated that it initially required a period of exclusivity at a MDU because without such "there was no assurance ... that, after spending a substantial amount of money for the purchase and installation of the cable system ... [it would] recoup its investment." Pl.'s Mem. In Opp'n to Defs.' Mot. To Dismiss at 5, <u>Comcast</u>

Cablevision of Arkansas. Inc. v. General Properties. Inc., et al., No. 96-5826 (Pulaski County Ct., Ark., 1996)

C. The Duration of Exclusive Contracts Should Not Be Capped

In the Second Further Notice in 95-184, the Commission sought comment on whether it should adopt a cap on the length of exclusive contracts entered into by MDU owners and service providers, limiting their enforceability to the time period necessary for a provider to recover their invested capital costs involved in initiating service at the MDU. This question is asked again in this proceeding.

The collective experience of IMCC's members indicates that exclusive contracting by PCOs is essential for their ability to compete with the highly financed incumbent franchised operators and now the RBOCs. Consequently, such provisions promote the best interests of MDU residents. Therefore, IMCC respectfully submits that an elimination of exclusive agreements or imposition of a cap of insufficient duration is not only unnecessary to promote the goal of increased competition but it would stifle the competition that has taken hold. However, should the Commission decide that a cap would serve the public interest, IMCC urges that any such measure allow exclusivity to extend for a period of years that is comparable to the period of de facto exclusivity enjoyed by franchised operators. Of even greater significance, the period should not be shorter than the period needed for PCOs to recoup capital expenditures and a reasonable period to generate a rate of return sufficient to attract additional financing so that additional MDU communities can be served.

IV. Financial Influences

Not only does exclusive contracting not thwart competition, it is a critical ingredient to insuring competition since only with a sufficient period of exclusivity can PCOs and other new entrants attract the investment capital necessary to initiate operations and to expand service to additional MDU communities, thereby enhancing competition. Such financing is already existent for franchised companies, the RBOCs and many telcos.

Most MDUs have a small subscriber base as compared with an entire municipality or area served by companies that enjoy franchises or have large telephony service areas as in the case of RBOCs. The PCO, without any real economies of scale, needs some period of exclusivity in order to generate a cash flow sufficient to achieve a reasonable profit which is, after all, the sine qua non for any debt and/or equity investment. So, in the real world of entrepreneurial financing, a PCO typically must install a complete stand-alone cable system, including satellite dishes, electronics and descrambling equipment at nearly every property they serve. These costs have only escalated with the delivery of the triple play. Without a period of exclusivity, the presence of a second provider on a property would simply render it economically infeasible for the PCO to survive, i.e., the available subscriber base, now shared, is too small to justify the capital investment.

This fact is demonstrated by the following model which is based upon a 300-unit MDU community and assumes that the PCO is unable to secure exclusivity vis-a-vis an incumbent franchised operator or RBOC currently servicing the MDU. The economics become even more troubling if the number of units declines. This is especially so if the penetration rate is below the 60% assumed in the model.

A. The fixed costs involved in installing a high-end stand-alone system at an MDU is approximately $800 per passing or $240,000 total for these 300 units. And now, with PCOs providing the triple-play, these costs increase.

B. The average penetration rate for any company providing video service at an MDU is between 55% and 60%, or in this example some 180 subscribers. Under the best of circumstances, a competitor can expect to obtain some 50% of those subscribers from the incumbent, or 90 subscribers.

C. Fixed costs, spread among the 90 subscribers, would equal approximately $2,600 per subscriber.

D. Monthly gross revenue averages $50 per subscriber in better markets, which would equal a total of $54,000 in gross revenue for the year.

E. Cash flow equals around 30% to 35% of revenue or approximately $16,000 per year in this model.

In the model, the ratio between annual cash flow and debt would be 14 to 1. Lending institutions strongly prefer this ratio to be in the range of 4 to 1 and virtually no such entity will provide financing if it is greater than 6 to 1.

However, if the provider is allowed to provide service pursuant to an exclusive access agreement, subscribers and thus revenue would double and the cash flow/debt ratio would be more in line with lending and investment standards. Moreover, without exclusivity, the fixed costs per subscriber are greatly above the market average of $1,500 to $2,000 per subscriber that is paid to acquire PCO systems. Investment under these circumstances would therefore be difficult to justify.

The lending and investment community is well aware of the critical need for exclusivity given the financial and competitive characteristics of PCOs as juxtaposed to the market dominance of the incumbent cable franchisees and now RBOCs, and often refuse to finance PCOs unless exclusivity is allowed. The vast majority of MDUs are already serviced by the very large and well-financed providers. Elimination of exclusivity or the imposition of a cap of unreasonable duration on exclusive contacts would mean that at most MDUs potential competitors would be unable to finance even the start-up of their operations, much less have any staying power or be able to expand service to additional MDUs. Consequently, competition in the MDU marketplace would be diminished and both MDU owners and residents would be left without a competitive choice.

The situation of the PCO is in stark contrast to that of the cable franchisee or RBOC that can serve a new MDU simply by stringing additional cable, twisted pair copper wire or fiber from that building to the nearest public street for interconnection to its franchise-wide or service area-wide single family head end or switching facility. While a cable franchisee or RBOC can amortize its installation expenses over its entire service area, a private cable operator in most instances must amortize its expenditures, which are frequently nearly four times higher, over only the single property served.

V. Industry Sample

The above financial description indicates why exclusive contracts are essential for the members of IMCC. Let us look at that industry to better understand the types of companies included in the industry and a statistical overview of pertinent facts.

It is difficult to determine the number of PCOs nationwide because there is no federal, state or local requirement to file information from which that number could be derived or to clearly portray the industry in other regards. However, the FCC 12th Annual Report to Congress Regarding Video Competition states, at page 62, that there were approximately 900,000 PCO subscribers in the year prior to March of 2006. We know that number has increased since, but we do not know by how much. If one assumes that PCOs have a 60% penetration rate that would indicate that PCOs pass some 1,500,000 MDU doors. Relative to the total number of TV households, including single family homes, this a small percentage. PCOs would have virtually no impact on that market to provide competition to the franchised companies or the RBOCs/telcos, if the latter at some point become a significant force. However, this is a significant number in the market focused on by PCOs, namely the 100 units or more MDU market. PCOs do then provide a salutary influence in the MDU market for enhanced competition for video and the triple play services. This then indicates that the Commission should be very cautious about taking any step that may reduce or eliminate PCOs from the marketplace.

This is particularly so when, as asserted by IMCC, their presence gives MDU owners more leverage in negotiating contracts with franchised cable companies and now the RBOCs. It should also be remembered that this leverage inures to the benefit of millions of MDU residents.

IMCC endeavored to compile information about PCOs and their circumstances regarding numerous issues relevant to this proceeding. IMCC conducted a sampling of smaller, medium and larger sized PCOs to portray a picture of this industry. Some of the questions and the PCO responses are described below.

A. How many MDU communities do PCOs serve? Small providers are in the range of 50 or fewer communities, medium up to 200 and larger rarely above 300 MDU communities. The majority of PCOs are at the lower end of that range; in fact only 3 operators are in the larger category.

B. Percentage of right of entry agreements ("ROEs") with exclusive service/access provisions? Unless the ROE includes a bulk service provision or the community is in a mandatory access state, some 75% of all ROEs include exclusive service/access provisions.

C. What is the range of PCO passings and subscribers, and what is the penetration rate? Some 50% of all PCOs have less than 3,000 passings. Another 30% have between 3,000 and 10,000 passings. The remaining PCOs have in excess of 10,000 passings with only a few having more than 25,000. The penetration rate ranges from 40% to 65%, with the majority in the 55% to 60% area. As a general principle, smaller PCOs have lower penetration rates because they are less likely to have exclusive service/access contracts and are less able to finance the build out of the triple play.

D. What is the average number of PCO employees? A high percentage of PCOs have fewer than 10 employees. Very few have more than 25 employees and only 4 have more than 75 employees.

E. What is the average annual revenue of PCOs? A strong majority of PCOs generate annual revenue of less than three million dollars. Perhaps 25% are between three and 10 million dollars per year, and only three or four are above that number.

F. What is the minimum number of years required to make an exclusive service/access agreement meaningful? The range is 5 to 10 years. The smaller and less financially secure PCOs require a longer term. The average for all PCOs is 7 to 8 years.

G. How many MDU-PCO ROEs include marketing agreements? A very high percentage, in the range of 80%.

H. How many ROEs include a bulk sales provision? A small percentage except in states with a large number of home owners associations or green field, new construction projects, or in states with mandatory access statutes.

I. Do PCOs provide service in states with mandatory access statutes? Clearly, PCOs prefer to provide service in non-mandatory access states and those that do have fewer ROEs. Yet the number of PCOs willing to go head-to-head in competition with the franchised cable company is growing, but at a slow rate. A reasonable approximation is that only 10 percent of PCO ROEs are in the 15 mandatory access statute states.

J. How often do PCOs encounter perpetual service agreements held by the franchised cable company? The number of such contracts has decreased in recent years and continues to decline. Yet, it seems that such provisions govern some 10 to 15% of all MDU units. Nationwide that would total 2 to 3 million units. Few of those units would then be available for service by PCOs. Unfortunately, the smaller the MDU owner, the more likely it is that their ROEs are controlled by perpetual provisions. It should also be noted that the number of such contracts has decreased just since IMCC started arguing against them and MDU owners put pressure on franchised cable to eliminate them.

VI. Other Evidence That The Market Is Enhanced By Exclusive Service Agreements

In Comments related to 95-184, we submitted an analysis prepared by Harvard economist Dr. Michael D. Whinston that supports IMCC's conclusions in this regard. The study analyzes the competitive effects of exclusive contracts between MDUs and MVPDs, particularly PCOs. The views and supporting documentation by Professor Whinston may be several years old but its conclusions are as valid and applicable today as then. These views include the following:

A. Dr. Whinston opines that "there is little risk of competitive harm arising from the use of exclusive contracts by PCOs." His report advances a sound rationale for why exclusive contracts serve important pro-competitive functions by making "exchange relationships" work more efficiently. For example, the ability to protect consumers via an exclusive contract against a socially inefficient overbuild, i.e., one in which the PCO as the initial investor necessarily faces unrecoverable economic loss. So these contracts achieve a pro-competitive result since without that ability, PCOs would not be able to invest in the MDU in the first place. This is in part due to the uncertainty of the future investments that a PCO will undoubtedly incur, be it for technology upgrades, additional competitive programming services or other non-contractible investments. Even the level of current investment undertaken at the time of initial MDU entry is greatly affected by the ability to obtain exclusivity, since the relative certainty of recovery for that investment allows for supracompetitive offerings redounding to the benefit of MDU residents. When these items are considered beyond the boundaries of a single MDU, it is clear that PCO market entry and growth has been and will continue to be directly linked to a PCO's ability to engage in exclusive contracting.

This is perhaps most dramatically evidenced, as Professor Whinston points out, by the lack of competition with incumbent franchised cable operators in mandatory access states. Mandatory access statutes prevent MDU owners and PCOs from engaging in exclusive contracts because the incumbent franchisee has a right to force entry into any MDU to provide service to residents. IMCC has documented that competition is more vigorous in non-mandatory access states.

B. Also, certain principles lead to conclusions that anti-competitive forces are at work. Third party buyers or sellers are negatively impacted by the exclusive contract if they are not a part of the negotiations prior to the contract's execution. That lack of bi-party negotiation is simply not present in the competitive milieu of MDU access battles occurring in markets where competitive alternatives exist.

Professor Whinston observes, "when all affected parties are involved in the negotiations over the contract, the exclusive contract will be signed precisely when it is efficient," and thus marketplace choice is advanced rather than eliminated. Such is typically not the case, however, with exclusive contracts lasting for the term of the franchise and renewals and extensions, i.e., de facto perpetual contracts. In the vast majority of jurisdictions where the use of such perpetual contracts is widespread, MDU owners often entered into contracts with a term linked to the continuation of the franchise because no competitive alternatives existed at the time. This presumes, as found likely by Professor Whinston, that negative externalities across buyers would not arise because the "extremely low level" of economies-of-scale enjoyed by PCOs renders it "highly unlikely that any PCO could profitably seek to use exclusive dealing contracts for anti-competitive ends" under market conditions where "all sellers are actively competing for contracts."

C. It should be noted that perpetual and perpetual exclusive contracts exist far more often

with smaller MDU communities. These are the very companies and residents that the FCC should be most concerned about and act the most vigorously to assist in preventing monopolistic or duopolistic practices, both now and in the future.

D. IMCC extensively briefed in its initial comments in 95-184 why marketplace

variables render attempts to establish a cap to be totally arbitrary. Professor Whinston concludes that balancing the low risk to competition posed by exclusive contracting by providers without market power or dominance versus the pro-competitive benefits achieved in the market due to such exclusive contracting, the Commission should simply refrain from placing artificial constraints on use of or the duration of exclusive contracting. Moreover, there are many benefits extracted by an MDU owner on behalf of residents in exchange for exclusivity that raise a PCO's investment far beyond just capital costs, e.g., specialized programming offerings, reduced rates, bulk agreements, customer service protections, et cetera. Recovery of these aspects of investment thus must also be taken into account.

In sum, based on Dr. Whinston's analysis, IMCC urges the Commission not to preclude such contracts or impose a cap on their use. If a cap is adopted its duration should not be less than the period of time to meet financial market standards to warrant such investment. However, such contracts, lasting in perpetuity, be they exclusive or non-exclusive, pose an entirely different anti-competitive barrier to entry. The same fact applies to contracts executed in mandatory access states.

There are numerous benefits to exclusive service contracts. The value of gaining exclusive access to residents on MDU properties creates a situation in which MDU residents collectively, through their landlord or ownership association, have more bargaining power vis-à-vis the very large MVPD providers. Residents of single family homes do not enjoy this benefit. A single resident can demand virtually nothing in terms of enhanced services or pricing discounts, but a thousand residents in an MDU complex can.

This collective bargaining power is of little value, however, if there are no alternative providers of service. In order to have leverage, the residents of the MDU must have a credible claim that they will take service from a competitive MVPD. The number of such alternatives is increasing so that the market today is much more sophisticated than it was a few years ago when the only option on most MDU properties was the MATV system provided by the MDU itself. Today, MATV no longer is a factor. But competitive providers such as PCOs, large and small, are pursuing alternative means of providing service to MDU properties.

E. Importantly, this not a situation in which the Commission should ensure that any one

solution, franchised cable or RBOCs or PCOs, wins in the competition to provide video services and the triple play to MDU residents. Each provider presents potential benefits to these residents and the Commission should not intervene in a way that would intentionally or inadvertently determine what the marketplace will determine on its own. Intervention may well produce a result inconsistent with allowing the free enterprise system to function which, in the longer term, is more efficient and beneficial for all concerned.

F. In fact, service relationships that do depend on the use of exclusive contracts often

result in superior services and prices for MDU residents. Exclusive contracts used by PCOs, for example, include provisions that require the PCO to provide comparable or better products and services than the franchised cable operator, at the same or a lower price. For instance, most PCO-MDU contracts include provisions that require the PCO to upgrade products to maintain parity with other providers in the area. This includes the delivery of new technologies. PCOs also offer channel selection guided by the demographics of the building population (Hispanic programming, senior programming, et cetera) and channels dedicated to in-house security and community distribution. This indicates that such contracts promote the efficient delivery of quality products and services.

G. Exclusivity not only promotes competition, it preserves the MDU owner's constitutionally protected private property rights and is the best method to advance the interests of the residents. Because the owner is itself faced with competition in the rental market, it has every incentive to ensure that the chosen provider will offer the highest quality services at competitive prices so that potential residents will be attracted to the property. The provider, in turn, is able to use exclusivity as the means to unlock supra-competitive offerings. With the guarantee of the entire customer base, a provider can afford to offer more expansive services and or pass on cost savings to the residents. Currently, where sufficient volume can be secured through exclusivity, PCOs typically offer services at rates approximately 10% below the next highest competitive rate for services at the individual resident level.

For the foregoing reasons, IMCC believes that exclusive contracts are a prerequisite for competition, not a hindrance, and that no limit on their duration is necessary other than the prohibition of perpetual contracts and the elimination of state mandatory access statutes. Should the Commission find otherwise and impose a regulatory regime on exclusive contracts IMCC urges such should be done only with respect to future contracts. Small providers, without market power or dominance, should be allowed to utilize such contracts so that they might obtain the investment capital to take the risk of making the initial capital expenditures, to fend off the onslaught of tactics used by franchised cable companies and now RBOCs to gain market share and to generate a reasonable rate of return on investment so that more capital can be secured to expand to additional MDU communities so that the benefits of this marketplace inure to more MDU residents.

VII. Market Power/Dominance and Small

Paragraph 12 of the NPRM asks "whether the Commission should limit exclusive contracts only where the video provider at issue possesses market power.

The Supreme Court has defined market power as "the power to control prices or exclude competition."[1] The FCC has characterized market power as "the ability to restrict output or raise price over what would prevail in a competitive market, and maintain it over time."[2] In other words, market power is "the power to raise prices without losing so many sales that the price increase is unprofitable."[3] Because market power is difficult to measure *per se*, and because there is a positive

[1] United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 391-92, 76 S.Ct. 994, 100 L.Ed. 1264 (1956).

[2] *Matter of Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service,* 1990 LEXIS 4103, 67 Rad. Reg. 2d (P&F) 1771 (rel. July 31, 1990).

correlation between market share and market power, courts use market share as a qualified proxy for market power in antitrust cases.

The Commission's proposal to regulate only those exclusive MDU contracts involving video providers with market power is consistent with the treatment of exclusive dealing agreements in antitrust law. Antitrust courts analyze the competitive effects of exclusive contracts using a "rule of reason" rather than a "per se" approach – based on the uncontroversial assumption that exclusive contracts may enhance or undermine competition in any particular market, depending on the extent of the market foreclosed to competitors by exclusivity. An exclusive dealing contract does not violate antitrust laws "unless the court believes it probable that performance of the contract will foreclose competition in a substantial share of the line of commerce affected." [4] Thus, Justice Frankfurter wrote in 1949 that exclusive dealing arrangements,

> …may well be of economic advantage to buyers as well as sellers, and thus indirectly of advantage to the consuming public. In the case of the buyer, they may assure supply, afford protection against rises in price, [and] enable long-term planning on the basis of known costs …[5]

This formulation precisely identifies the rational for exclusive contracts in most business situations, including MDU markets for video programming services: not to suppress competition, but to make the market perform better in conditions of uncertainty.

Competitive problems arise when one of the parties to an exclusive contract controls so much of the market that competitors are unable to bid for contracts at

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[3] Hovenkamp, Economics and Federal Antitrust Law (St. Paul, Minn. 1985), pp. 55-56.

[4] In Tampa Elect. Co. v. Nashville Coal Co., 365 U.S. 320, 327-328, 81 S.Ct. 623 (1961), the Supreme Court stated, regarding exclusive contracting: "To determine substantiality [of foreclosure] in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce … and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein." *See also*, Seafood Trading Corp. v. Jerrico, Inc., 924 F.2d 1555, 1567 (11th Cir. 1991)(a party may choose with whom he will do business or not do business, and such exclusive dealing will not give rise to liability absent showing of actual competitive harm).

[5] Standard Oil Co. of California v. United States, 337 U.S. 293, 305-6, 69 S.Ct. 1051 (1949).

all – stated otherwise, when one of the parties enjoys the market power conferred by overwhelming market share, such that the use of exclusive contracts, whether by design or in effect, forecloses competitors from entering the market at all.

In a Report submitted to the Commission during the 1998 Inside Wiring proceeding, Professor Michael Whinston formulated this point as follows:

In order for an exclusive contract to have an anti-competitive effect, there must be third parties who are negatively affected by the contract, but not present in the bargaining leading to the formation of the contract. By contrast, when all affected parties are involved in the negotiations over the exclusive contract, *the exclusive contract will be signed precisely when it is efficient.*

In a competitive market, where consumers, and their landlord proxies, have multiple options among MVPD providers, exclusive contracts are more likely to enhance competition (*e.g.,* by stimulating capital markets to fund smaller, independent entrants such as PCOs, by enabling super-competitive service and product offerings, and so on) than to undermine competition. This should be the case in MVPD markets where, according to the Commission, there is intense competition in MVPD markets: "We find that almost all consumers have the choice between over-the-air broadcast television, a cable service, and at least two DBS providers."[6]

This statement is as true of MDU markets as it is of single-family home markets: MDU owners, in order to attract and retain high-value, tech-savvy tenants, aggressively solicit service proposals from numerous vendors, including franchised cable companies, telephone companies, and PCOs; when, as a result of competitive bidding, one of those vendors is awarded an exclusive contract of

[6] *Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eleventh Annual Report (Rel. Mar. 3, 2006)("2006 Video Competition Report"), ¶ 5.

limited term, this generally means that that provider was willing to offer super-competitive service to residents at superior prices.

Therefore, exclusive MDU contracts are not anti-competitive *per se*, and in fact enhance competition when multiple providers are able to compete for exclusive access to MDU buildings. Such contracts are anti-competitive only when used to undermine the possibility of competitive entrants bidding for access (exclusive or non-exclusive) to MDU buildings in the first instance. Only firms with significant market power are in a position to use exclusive dealing in this anti-competitive manner.

The Commission's recent reports on video competition and on cable pricing leave no doubt that their dominant subscriber share gives franchised cable operators significant pricing power in MVPD markets generally, and in MDU markets in particular.

For example, when Congress passed the Cable Television Consumer Protection and Competition Act of 1992, only 60% of the country subscribed to a cable service, and the largest cable systems controlled at most 25% of those subscribers. Since 1992, cable's market share has only increased. According to the most recent FCC Report on MVPD competition, 69.4 percent of MVPD subscribers received video programming from a franchised cable operator.[7] Moreover, vast market share is increasingly concentrated in only a few dominant, vertically-integrated firms: The FCC's 2006 Video Competition Report states that while in 2005 "the four MVPDs with the largest subscribership served 63 percent of all MVPD subscribers…," a 5 percent increase over 2004.

These national numbers mask presumably higher levels of regional concentration, particular in the wealthiest urban areas where most MDU properties are located. As noted in the 2006 Video Competition Report, "cable operators continue to pursue a regional strategy of 'clustering' their systems … At the end of 2004, there were 118 clusters with approximately 51.5 million subscribers …"[8]

[7] 2006 Video Competition Report, ¶ 8.
[8] 2006 Video Competition Report, ¶¶ 154-155.

Thus, cable's domination of video distribution in MDU markets is significantly greater than the national market share numbers suggest.

The cable industry's dominant market share allows franchised cable companies to impose switching costs on their subscribers, raise prices, deny programming to rivals and favor affiliated programming, such as highly valuable local sports channels, over unaffiliated programming. Not surprisingly for an industry possessed of substantial market power, cable rates have been steadily rising, far outpacing the general rate of inflation.[9] The Commission's recent Report on Cable Industry Prices documents this ongoing trend in some detail: "Overall, cable prices increased more than 5 percent [in 2005] and by 93 percent since the period immediately prior to Congress's enactment of the Telecommunications Act of 1996. Expanded basic prices rose more than 6 percent or twice the rate of inflation last year."[10]

The cable industry's power to raise prices while simultaneously expanding cable's share of the MVPD market clearly demonstrates market power under any accepted definition. Consequently, it is not surprising to find franchised cable companies using exclusive MDU access agreements to foreclose significant portions of the MVPD market to new entrants, including both telephone companies deploying fiber networks and PCOs utilizing DBS technology.

The best example of cable's use of exclusive MDU contracts to suppress competition is the persistence of *de facto* "perpetual" exclusive access agreements, that remain in effect for the duration of the franchise and any renewals thereof. These contracts, by virtue of exclusivity – *combined with an unlimited perpetual term* – effectively preclude competitive entrants from bidding for MDU access at all, and thus illustrate Professor Whinston's point regarding the particular circumstances under which exclusive contracts entail anti-competitive effects.

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[9] GAO Report to Congress, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry* (Oct. 2003), p. 20; *see also*, 2005 Video Competition Report, ¶ 26.
[10] *Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, Report on Cable Industry Prices (Rel. Dec. 27, 2006), ¶ 2.

Another example occurs where a franchised cable company is able to dominate an entire geographical market by means of a system-clustering strategy (and the economies of scale and scope achieved through clustering), and then lock in virtually all MDU properties in the area through the use of long-term exclusive MDU contracts. Here again, it is not exclusive contracts *per se* that negatively affect competition, but only their use to lock out competitors from the MDU bidding process altogether. Because PCOs have extremely low economies of scale – meaning, the costs incurred by a PCO in providing video services are incurred on an MDU-by-MDU basis – PCOs are unable to use exclusive contracts to suppress competition.

In paragraph 11 of the NPRM, the Commission asks whether the existence of exclusive contracts within a community reduces the likelihood of competitive entry within the community. As demonstrated above, the answer is: exclusive contracts reduce the likelihood of competitive entry within a community only where such contracts, whether by design or in effect, block or deter new entrants from bidding for MDU access within that community at all. And that occurs only when the incumbent provider possesses dominant market share, and thus is able to use exclusive access agreements to lock out competitors altogether.

Of course, no PCO, either alone or in combination with other PCOs, possesses market power. According to the Commission, PCOs have perhaps one million subscribers nationwide – a miniscule market share. The largest PCOs have approximately 40,000 subscribers nationwide, which is one-tenth the FCC's benchmark (*i.e.*, 400,000 or fewer subscribers nationwide) for designating a "small cable system." And no PCO has annual revenues anywhere close to the Small Business Administration's benchmark for a "small business" in Cable and Other Program Distribution (*i.e.*, less than $13.5 million in annual receipts). In other words, and in stark contrast to franchised cable operators, PCOs are small businesses, deploying small cable systems in small private communities.

Because PCOs lack market power, the use of exclusive MDU contracts by PCOs cannot possibly foreclose a sufficient portion of the market to cause competitive harm. On the other hand, as demonstrated earlier in these Comments, without the ability to form exclusive contracts, the PCO industry would very likely disappear.

Therefore, the Commission must ask itself whether it is in the public interest to eliminate an entire class of competitors from the market for the purpose of enhancing competition in that same market.

On the other hand, the Commission can take some meaningful action in this area, by restricting its regulatory intervention to the practice that actually distorts the competitive market – the use of exclusive MDU contracts by dominant firms with market power to subvert or deter competitive entry.

VIII. Other Ways to Enhance Competition

If the Commission is serious about enhancing competition from numerous categories of providers, and not simply assisting franchised cable and new RBOCs/telcos, IMCC urges action in at least the following three areas:

A. Mandatory Access Statutes

In effect, most state mandatory access laws prohibit any provider other franchised cable operators from forming exclusive service contracts with MDU owners. Therefore, if there is any doubt regarding whether exclusive contracts undermine or enhance competition generally, the Commission should compare the state of competition in mandatory access states versus non-mandatory access states. As the Commission itself emphasized in 2003: "Many parties assert that less competition exists in the MDU marketplace in states that have mandatory access statutes, and the evidence we have on the record supports these assertions…We continue to believe that mandatory access laws may impede competition in the MDU marketplace and that they tend to preclude alternative (non-cable) MVPDs form executing MDU contracts. This is due to the fact that most mandatory access laws give the franchised cable operator a legal right to wire and remain in an MDU." More precisely, mandatory access laws undermine competition to the extent they preclude alternative MVPDs from executing exclusive contracts. "The predictable result is that competitive providers are less likely to take the financial risk of entering, or to secure the necessary financial backing to enter, the MDU marketplace in a mandatory access state." The Commission need only review its own prior analysis on mandatory access policy to reach a sensible result in this proceeding.

In addition to undermining competition by precluding the formation of exclusive MDU contacts by non-cable MVPDs, mandatory access laws are patently discriminatory in intent and effect, and impede competition for that reason as well.

State mandatory access laws almost always discriminate unfairly in favor of franchised cable operators by forcing property owners to grant access to those providers but not extending the same advantage to other video service providers.

Such laws chill competition from alternative providers since owners are reluctant to grant access to them when on day one the PCO builds out the property and then on day two the larger operators, like franchised operators, use such statutes to force the owner to consent to a cumbersome overbuild. In all these cases it makes little sense for the MDU owner to allow such disruption and for the PCO to incur the cost of such system build outs with little chance of recouping the investment let alone make a profit.

These laws do not even ensure that the residents receive cable service since the franchised operator is not obligated to exercise its right of forced access upon a resident request for service. Rather, the franchised operator may choose to force access only if service will be economical from that operator's perspective.

In the end, state mandatory access laws are simply another competitive tool for the franchised operators that can use the provisions simply to target a competitor's subscriber base and drive it out of the market.

IMCC urges the Commission to level the playing field by prohibiting operators with market dominance or power and clearly are not small from obtaining exclusive contracts in states that have enacted a mandatory access statute. The prohibition could be tied directly to the existence of the forced access statute so that if the statute is repealed, the prohibition would be lifted and all parties would remain on equal footing.

B. Perpetual Service Contracts

Property owners must provide quality and current video programming services in order to attract residents. Twenty years ago, in most places, there was only one means to get that service so MDUs signed contracts that no longer make sense for the MDU or the residents. Today that is still the case. Property owners therefore did not have, and often still do not have, any leverage in their dealings with these providers enjoying the monopolistic results of these contracts. These contracts are still in use today in markets to which alternative providers have not been able to extend their reach and thus where property owners have no service option other than franchised cable, or potentially in the future RBOCs and telcos.

If PCOs are foreclosed in perpetuity from obtaining the exclusivity necessary to initiate operations, these potential competitors will never be allowed to challenge incumbents and the market will never be energized by competition among providers for the right to serve properties as existing contracts expire.

Perpetual contracts are in essence contracts of adhesion. If perpetual contracts are to be enforceable under traditional contract principles, many courts would require that they must be renegotiated in an environment of relatively equal bargaining power as service alternatives become available to property owners. Moreover, while many courts would treat the contract as terminable at-will, an incumbent would not acquiesce to such an interpretation. Rather, it would require a lawsuit to obtain that judicial construction and such an expense would deter the property owner from asserting its termination right.

In light of their overwhelming anti-competitive effect, IMCC urges the Commission to establish a three year fresh look period during which time property owners are empowered to renegotiate both exclusive and non-exclusive perpetual contracts, with full consideration of today's service alternatives. This would provide MDU owners the opportunity to negotiate from a position of much more equal bargaining power.

As a preliminary matter, the Commission must be as clear as possible regarding what contracts are considered perpetual and therefore subject to a fresh look. Further, the mechanism should be triggered on a building-by-building basis. When the owner of an MDU believes that there are competitive alternatives to the large provider's service available to it, it can invoke the mechanism and solicit competing offers of service.

Nothing in such a regime would prevent the property owner from simply entering into another contract with the incumbent operator, with or without entering into a second agreement with a competing provider. It would simply empower the owner to transform an anti-competitive contract into one that will be subject to renegotiation at set intervals and thereby forced to stand the test of competition. Indeed, the incumbent presumably would have the advantage due to a property owner's general hesitancy to switch providers and this leverage would almost certainly inure to the benefit of the residents because the incumbent operator will want to maintain the ROE and would offer better products and services to do so.

C. FCC MDU Inside Wiring Rule Improvements

When the Commission adopted the MDU Inside Wiring Rules, PCOs and MDUs were enthused that these rules would allow competition to flourish and provide significant benefits to residents. We think the Commission intended that the Rules help accomplish those objectives and made clear its intent. To be sure, MDUs and PCOs have utilized the Rules so that the home run wiring could be used by alternative providers to enhance competition.

Unfortunately, the Rules are unclear regarding many issues that arise as MDU owners seek to bring alternative providers, such as PCOs, onto their properties to benefit residents as opposed to continuing service by the incumbent provider. It also has been frustrating that in many instances the incumbent provider, almost always the franchised cable company, has ignored the Rules, obstructed application of the Rules and seemingly intentionally mislead MDU owners about how the Rules are to be applied. All of which are tactics to intimidate the MDU owner to assure that the owner simply renews the ROE that is set to expire. This, of course, is contrary to the Commission's intent and frequently is in violation of the regulations. Therefore, the benefits intended by the Commission have not been made available to many residents.

IMCC has repeatedly urged the Commission to amend the Rules, clarify how they are to be used or bring enforcement actions so that franchised cable companies are no longer allowed to impede utilization of the Rules. The Commission has not done so in any meaningful way and, consequently, has allowed the Rules to be far less significant than if the Commission had taken appropriate action to clarify and enforce the Rules.

Following are merely a few of the questions raised by IMCC:

i. Are the unit-by-unit portions of the Rules to be interpreted consistent with the CSC Holdings, Inc. v. Westchester Terrace, et al (Southern District, NY., docket no. 01-CIV-8134, Oct. 2002) case or the Time Warner Entertainment v. Atriums Partners, L.P. (D. Kansas, docket no. 02-2343-CM) case?

ii. Do the Rules allow the incumbent to assert that since the home run coaxial cable can be used for telephony and high-speed data purposes the Rules do not apply to video?

iii. If the incumbent operator refuses to cooperate with the MDU owner's application of the Rules, by among other tactics ignoring the time thresholds in the Rules, is that operator deemed to have abandoned its right to use the home run wiring and any subsequent selection of sale or removal?

iv. If the incumbent operator spuriously tells the MDU owner that the ROE precludes application of the Rules has the operator violated the Rules?

v. If the incumbent refuses to comply with the mandatory provisions of the Rules such as by not cooperating with application of the Rules, e.g., waiting until the last moment to allow transition of the home run wiring from the incumbent's control to the control of the successor operator, has the incumbent violated the Rule?

vi. Has the FCC ever brought an enforcement action against any incumbent for violation of the Rules?

IX. Conclusion

Some seem to think the very word "exclusive" is sinister. Some also seem to think one type of provider is identical to any other type. They also seem to think that such contracts diminish competition and are damaging for residents. To the contrary. The word and its use in MDU-PCO contracts can be beneficial for users. Such provisions are not pernicious but are consistent with enhanced competition and the philosophy of non-governmental intervention. PCOs are a unique breed of video providers. They have dramatically different business models without deep pockets. They do require these contract provisions if they are to continue to serve niche markets. Without them PCOs could not find the financing essential to initiate and maintain service so a profit can be generated to expand to other MDU communities. This is true for small operators, without market power or dominance. We urge the FCC to recognize that such contracts are no less productive than when studied in the past. They are still essential if PCOs are to serve customers so that not only franchised operators or RBOCs can succeed. We request that the Commission recognize that PCOs are unique and serve a positive purpose and they will only persist if such contracts are not forbidden.

Respectfully submitted,

This 18th day of June, 2007

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